



Advocates for Rural Broadband

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May 29, 2015

Filed Via ECFS

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

RE: Connect America Fund, WC Docket No. 10-90

Dear Ms. Dortch:

On Wednesday, May 27, 2015, Genny Morelli and Micah Caldwell of ITTA – The Voice of Mid-Size Communications Companies (ITTA); Jim Frame and Jeff Dupree of the National Exchange Carrier Association, Inc. (NECA); Michael Romano and Josh Seidemann (via telephone) of NTCA – The Rural Broadband Association (NTCA); Lynn Follansbee of the United States Telecom Association (USTelecom); Cheryl Parrino of Parrino Strategic Consulting Group (PSCG); Stephen Kraskin of the Rural Broadband Alliance; Mark Gailey of Totah Communications, Inc. (via telephone); Bob DeBroux of TDS Telecom; Denny Law of Golden West Telecommunications Cooperative (via telephone); Ryan Boone of Premier Communications (via telephone); Trey Judy of Hargray Communications; Wendy Fast of the Consolidated Companies; Ken Pfister of Great Plains Communications; Keith Oliver of Home Telephone Company; and Derrick Owens (via telephone) and Gerry Duffy representing WTA – Advocates for Rural Broadband (WTA) (collectively, the “RoR representatives”) met with Commissioner Michael O’Rielly; Amy Bender, his Legal Advisor – Wireline; Rebekah Goodheart, Legal Advisor- Wireline to Commissioner Mignon Clyburn; Travis Litman, Legal Advisor to Commissioner Jessica Rosenworcel; and Carol Matthey, Alexander Minard, David Zesiger and Steve Rosenberg (via telephone) of the Wireline Competition Bureau to report on the status of the ongoing negotiations by a variety of industry representatives looking toward the development of a comprehensive plan for future high-cost support for rate-of-return (RoR) carriers.

The RoR representatives reiterated that they have agreed upon a basic two-path approach composed of: (1) updates to existing mechanisms; and (2) a Model-Based Path. Given that the previous May 20 meeting had focused primarily on the Model-Based Path, the present meeting was comprised principally of discussions regarding updates to existing mechanisms.

Several RoR representatives expressed the need for RoR high-cost support mechanisms that can ensure stability and predictability during the ten-year term of the contemplated plan to carriers and study areas that elect not to voluntarily opt into the contemplated Model-Based Path as they deploy broadband. Whereas the RoR representatives that have developed and supported the evolving Data Connection Support (DCS) plan continue to believe that it is a reasonable and equitable approach, they are willing to discuss alternatives and/or further DCS revisions that would provide needed support and deployment incentives for broadband-only lines. In particular, certain RoR representatives have been exploring suggestions that voice-capable broadband-only lines be supported within existing mechanisms, and have been working through various allocation, separations, cost recovery and implementation issues.

Several RoR representatives responded to concerns expressed by the Bureau by proposing potential limits on operating expenses supported by existing mechanisms. The limit formula, which is patterned to some degree on that currently applied to other operating expenses, is detailed in Attachment A hereto.

The Capital Budget Mechanism (CBM) that was first proposed in April 2011 by certain RoR representatives (and which has been refined substantially over the past four years following continuing consultation with Bureau staff to include aspects such as per-location “triggers” or limits on eligible capital expenses) was also discussed. Although the RoR proponents understand the Bureau’s concerns that the use of embedded costs by the CBM could be perceived to perpetuate some instances of past inefficient investment, they have not heretofore been able to identify any alternative that is more accurate or effective in addressing investment issues. The RoR proponents of the CBM expressed their continued interest in exploring alternatives, and welcomed suggestions from the Commission.

The RoR representatives recognized and agreed that no broadband subscriber line charge needs to be tariffed in connection with the plans under consideration. However, DCS proponents continue to struggle with the nature and amount of the benchmark or benchmarks necessary to ensure that equitable portions of the costs of broadband-only lines are recovered from consumers. Whereas DCS proponents understand that some may have concerns about their currently proposed benchmark applicable to regulated wholesale broadband transmission service, DCS proponents have emphasized and demonstrated through a series of evidentiary filings that this wholesale benchmark, when combined with retail price elements, is consistent with rate surveys indicating that consumers pay approximately \$70 per month for 10/1 broadband service. The DCS proponents indicated that they have struggled with the problem of how to develop and apply benchmarks to non-regulated retail broadband services that are offered, in many cases, by affiliated and non-affiliated Internet Service Providers (ISPs) that are neither eligible telecommunications carriers (ETCs) nor subject to pricing regulation.

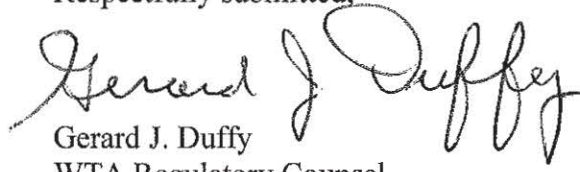
The RoR proponents of the DCS plan have proposed a mechanism for reducing and capping of DCS support, if necessary, to stay within the confines of the overall budget for RoR high-cost support mechanisms. They believe that this proposed mechanism resolves potential budget issues.

The RoR representatives agree that recipients of broadband-only support should be accountable for using it to invest in broadband infrastructure, to repay loans for recent broadband construction, and to operate their broadband-capable networks.

This ex parte reflects the current status of the negotiations. The RoR representatives are committed to continuing to work together on this process and will continue to report their progress.

Pursuant to Section 1.1206(b) of the Commission's Rules, this submission is being filed for inclusion in the public record of the referenced proceedings.

Respectfully submitted,


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Rebekah Goodheart
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Carol Matthey
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David Zesiger
Steve Rosenberg

Attachment

Attachment A

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Preliminary Alternative For Opex Limits

(Regression Model Based on Housing and Business Units and Density)

Total Costs Assigned to the Loop \$ Million

| | | |
|--|-------------------|---------------|
| Maintenance Expense | \$ 393.2 | 12.6% |
| Network Support Network Operations and General | \$ 310.4 | 9.9% |
| Benefits | \$ 246.3 | 7.9% |
| Rents | \$ 57.4 | 1.8% |
| Corporate Operations Exp | \$ 462.4 | 14.8% |
| Depreciation Expense | \$ 805.4 | 25.8% |
| Return on Investment (ROI) | \$ 684.5 | 21.9% |
| Taxes | \$ 162 | 5.2% |
| Total Costs | \$ 3,121.8 | 100.0% |

| | <u>% of Total</u> |
|--|-------------------|
| ROI and Depreciation Expense would be limited by proposed Capital Budget Mechanism | 47.7% |
| Corporate Operations Expense Limited by existing FCC Formula | 14.8% |
| Taxes are beyond Company Control | 5.2% |
| Remaining categories subject to potential Opex limit account for approximately of total company costs assigned to the loop and approximately 41.3% of total expenses | 32.3% |

- **Highlighted expenses (“Other Opex”)** could be limited by comparing companies’ monthly expenses per location to regression model generated monthly expenses per location, plus two standard deviations. Adding two standard deviations to regression results is a common practice for identifying outliers. This method has been applied by the FCC in constructing voice and broadband rate ceilings.
- **Regression Model**
 - “Other Opex” per location are related in a regression to locations and density.
 - Locations include housing units and business units. Density is defined as locations per square mile. Source for housing units is U.S. Census. Study area boundaries were obtained from FCC data. Source for business locations is A-CAM. Business locations account for about 15% of total locations.
 - The location variable was used in its reciprocal form to capture the economies of scale evidenced in the data and is consistent with the presence of fixed costs.
 - The density variable was transformed to capture initial economies followed by diseconomies of density for very high density areas (logarithmic transformation with linear and square terms).
 - R-square is 34.2 % (FCC’s Corporate Opex Limit Formula has R-Square of 29%)

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- **Limit formulas** are constructed by adding two standard deviations to regression results. Standard deviations are calculated and applied separately for two density size groups (with 1.5 locations per square mile used as the threshold). The formulas are given below.

Monthly Limit per Location = $101.94 + 9,399 / \text{Locations} - 10.9334 \times \ln \text{Density} + 1.2816 \times (\ln \text{Density})^2$
If density is less or equal to 1.5

Monthly Limit per Location = $77.98 + 9,399 / \text{Locations} - 10.9334 \times \ln \text{Density} + 1.2816 \times (\ln \text{Density})^2$
If density is greater than 1.5

- The limits are based on cost company data only.
- Thirty nine study areas limited with approximate savings \$16M.
- The formula coefficients will be re-estimated and limits re-evaluated after business location counts are updated to reflect corrected study area boundary maps.
- Monthly per-location Opex limits calculated based on the final formulas would be adjusted each year for inflation to reflect the annual percentage change in the United States Department of Commerce's Gross Domestic Product-Chained Price Index (GDP-CPI).
- Linear regression with outlier weights was used to estimate the regression coefficients. The DFFITS statistical method for outlier accommodation was used to determine the outlier weights.
- The sample size for the regression was 773 out of 775 cost study areas. Two study areas were excluded due to lack of Census data.
- Data sources used were as follows:
 - for Opex cost data, 2014 USF data submission for 2013 accounts
 - for Housing units, Census data and study area boundary maps reported to FCC
 - for Business locations, A-CAM Version 1.0.1 or estimates based on housing units and average ratios for study areas not included in A-CAM
- Outlier weights were also applied in the calculation of the R-square statistic and of the standard deviations.
- Standard deviations were calculated for two groups of study areas defined by density as follows:
 - for 86 study areas with density values below or equal to 1.5 locations per square mile, the weighted standard deviation is 29.7567.
 - for 687 study areas with density values above 1.5 locations per square mile, the weighted standard deviation is 17.7731.
- All regression coefficients are statistically significant at 99% confidence level as evidenced by high t-statistic values shown below, with the weighted R-square statistic of 34.2%.

| Variable | Parameter Estimate | t Value | Pr > t |
|-------------------|--------------------|---------|---------|
| Intercept | 42.4297 | 29.21 | <.0001 |
| 1/ Locations | 9399.4471 | 9.94 | <.0001 |
| Ln Density | -10.9334 | -10.34 | <.0001 |
| LnDensity Squared | 1.2816 | 5.67 | <.0001 |